REPORT BY THE

AUDITOR GENERAL

OF CALIFORNIA

BETTER ADMINISTRATION AT THE DEPARTMENT OF VETERANS AFFAIRS CAN IMPROVE SERVICES TO VETERANS

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Thomas W. Hayes
Auditor General

December 2, 1985 P-548

Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the Department of Veterans Affairs' administration of the Cal-Vet Farm and Home Loan Program. The report shows a need for the department to adopt standards that are similar to those used by private mortgage lending institutions.

We conducted this audit to comply with Item 1960 of the "Supplemental Report of the 1985 Budget Act."

Respectfully submitted,

Thomas W. Hayes

THOMAS W. HAYES
Auditor General

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SUMMARY

The California Department of Veterans Affairs (department) could improve the administration of the California Veterans Farm and Home Loan Program (Cal-Vet program) by adopting standards that are similar to those used by private lending institutions. The department takes an average of 84 days to process some Cal-Vet loan applications, while private lenders typically average 32 days. Furthermore, the department sometimes takes over one year to initiate action against many veterans who are delinquent on their loans; private lenders initiate action against defaulted loans within an average of 16 days. If the department adopted standards similar to those of the private lending institutions, it could expedite loans for California veterans and eliminate the need for some veterans to obtain interim, more expensive financing.

The Department Takes Too Long To Process Loan Applications

The department takes significantly longer than private sector lenders typically take to process loan applications. We reviewed a statewide random sample of 304 Cal-Vet loan applications that had been approved and found that the department's average processing time, from the date the veteran completed the minimum loan application requirements to the date the loan was funded, was 84 days. Furthermore, 6 of the department's 11 district offices took longer than the statewide average to process some home loan applications.

One reason for the department's longer processing time is that the district offices process loan applications differently. Only 2 of the 11 district offices normally use a credit agency to verify the credit information provided by a veteran, and 8 of the district offices had used private appraisers to complete property appraisals during

periods of heavy workload in the district offices. In addition, loan application files and documents were not always completed according to the department's guidelines.

Furthermore, the department does not have a system to monitor the time that district offices take to process a loan application. Private sector loan institutions have systems to monitor the processing of loan applications and to identify the time it takes to process an application. After the loan application has been processed, an underwriter or loan processor reviews the loan application and then a central loan approval committee makes the final decision to fund the loan. However, the department does not have a system to monitor the processing of loan applications in the district offices and does not routinely prepare reports on the loan applications processed by the district offices. Moreover, the department management does not review the loan applications approved by the district office managers.

Another reason why the department may not be processing loans as promptly as it should is that the department has many unfilled positions in its district offices. For example, the San Bernardino district office has had two unfilled property agent positions since August 1, 1985, and currently there are only two of four authorized property agents in the Bakersfield district office. During fiscal year 1984-85, the department had 10 unfilled positions in eight of its district offices.

Because the department has taken too long to process Cal-Vet loan applications in some instances, veterans have had to obtain interim financing to purchase their homes. Veterans who obtain an interim loan are required to pay an interest rate that is higher than that charged by the department, and they must also pay service charges and fees for processing the loan application. For example, a veteran seeking interim financing until his Cal-Vet loan is approved to purchase a home would be required to pay, in addition to a higher interest rate, an average service charge of $1,560 for a loan of $75,000 and loan processing fees of $400.

The Department Takes Too Long To Cancel Loans and Is Not Consistent in Its Methods of Reselling Repossessed Property

The department's rate for repossessing homes from veterans who fail to make payments is significantly lower than repossession rates of other lending institutions. However, the department could cancel delinquent loans more promptly. The district offices act much more slowly than do private lending institutions to cancel loans and repossess properties for which veterans fail to make payments for an extended period. In addition, the department lacks adequate standards for the resale of repossessed properties. We reviewed a random sample of 93 properties that were repossessed by the department; in some cases, veterans were delinquent in their payments up to 19 months before the district office took the action necessary to cancel the loan.

In addition, the district offices we visited do not use the same methods to sell repossessed properties and are not consistent in giving veterans priority to purchase these homes. Each district manager individually determines how a repossessed home will be sold. For example, at the San Bernardino district office, the district manager does not always list repossessed properties with real estate brokers, and he accepts the highest offer for the property. At the North Sacramento district office, the district manager advertises the property, accepts bids for a specified period, and gives veterans priority to purchase repossessed property.

The department does not exercise adequate control over the district offices to ensure that they take action to repossess properties as quickly as they should. For example, the department does not receive routine reports on delinquent contracts or repossessions, and the department has not set time limits for the district offices to take the necessary action to cancel a delinquent loan. The losses that

the department has incurred because of delays in cancelling delinquent loans have not affected the interest rate charged to veterans. However, the department loses revenue when a veteran fails to make monthly mortgage payments. In one instance, for example, a veteran accumulated over $3,700 in delinquent payments over a 21-month period before the district office initiated action to cancel the delinquent loan.

The district offices do not have uniform methods for disposing of repossessed properties. Moreover, the department has not monitored the district offices' resale of repossessed properties to ensure that their methods are consistent and that veterans are receiving preference in the purchase of these properties. As a result of inconsistent district office practices, veterans are not always receiving special consideration at all of the district offices.

INTRODUCTION

The Department of Veterans Affairs (department) offers long-term, low-interest loans to California veterans to purchase farms or homes. Eligible California veterans, with some exceptions, have 25 years following their release from active military service to apply for farm and home loans under the California Veterans Farm and Home Loan Program (Cal-Vet program).

Since 1921, the department has made loans to over 366,000 California veterans. Currently, the department has over 108,000 active Cal-Vet loans valued at approximately $3.14 billion. In 1983, the Legislature established loan maximums of $75,000 for homes, $80,000 for homes with solar equipment, $55,000 for mobile homes in mobile home parks, and $200,000 for farms. Beginning July 1, 1985, the Legislature required the department to process and approve Cal-Vet loans in 90 days.

To provide funding for Cal-Vet loans, the department, at intervals, sells general obligation and revenue bonds. Veterans who receive loans are charged the lowest interest rate that will both repay the bonds and fund all of the department's administrative costs for the Cal-Vet program. When the department approves a Cal-Vet loan, it buys the home or farm and sells it to the veteran through a contract of sale.

Federal and state laws regulate the use of general obligation and revenue bonds as well as the amount of each type of bond that may be sold in a calendar year. Federal regulations require that revenues from bonds be used to fund loans for veterans who served before January 1, 1977, and who applied for a loan either within 30 years after leaving active military duty or before January 1, 1985, whichever is later. According to state law, the department must hold in reserve at least 10 percent of the funds from all revenue bonds issued to ensure payment of the bond commitments. Federal law also requires the department to reserve 20 percent of each revenue bond sale for one year for loans to veterans who purchase homes in certain economically depressed areas of the State.

Although the Cal-Vet program is the department's largest program, the department also administers two other programs for California veterans. In one program, the department provides consultation and assistance to veterans and their dependents in filing claims and obtaining benefits to which they may be entitled under state and federal laws. In the other program, the department provides support for the Veterans Home of California, where veterans are provided with complete nursing care and hospitalization.

The department's estimated budget for fiscal year 1984-85 is over $988 million, of which approximately $22.3 million is supported by the General Fund.

SCOPE AND METHODOLOGY

The purpose of this audit was to examine the Department of Veterans Affairs' management of the California Veterans Farm and Home Loan Program. We reviewed a random sample of loan applications from throughout the State that the department received and funded between fiscal years 1982-83 and 1984-85. We used this sample to determine how long it took the department to process a loan application and to determine the causes of delays in processing loan applications. We visited 3 of the department's 11 district offices to review the procedures used in processing loan applications and repossessing properties. We reviewed a random sample of homes repossessed by the department to determine the department's methods for disposing of these properties. From the repossessed home files, we were unable to determine if those who purchased repossessed property sold by the department were relatives or friends of department staff. We also contacted county tax assessors to determine if those purchasing repossessed property sold and financed by the department were using the property to generate income.

To compare the department's loan processing policies and procedures to those used in the private sector, we visited two mortgage lending institutions in Sacramento that provide loans for farm and home mortgages. We also gathered information from these lending institutions about their procedures for foreclosing on delinquent loans. We contacted an additional 13 banks and savings and loan

associations in California and the Federal Veterans Administration to determine their standards for processing loan applications.

During our review, we interviewed department and district office staff to identify the policies and procedures used to administer the Cal-Vet program. We also interviewed department staff to become familiar with the property purchase system, a computerized system for maintaining loan contracts, and the proposal to improve this system. Finally, to determine the adequacy of the department's ability to forecast the funding requirements for Cal-Vet loans, we reviewed the department's cash forecasting model.

AUDIT RESULTS

I

THE DEPARTMENT OF VETERANS AFFAIRS DOES NOT MEET INDUSTRY STANDARDS FOR PROCESSING LOANS

Some California veterans have experienced delays in obtaining farm and home loans and have had to seek more expensive interim financing because the Department of Veterans Affairs (department) takes too long to process applications for loans under the California Veterans Farm and Home Loan Program (Cal-Vet program). Among the department's district offices, processing Cal-Vet loan applications takes an average of 67 to 105 days. In contrast, private mortgage institutions process loan applications in an average of 32 days. Furthermore, 6 of the department's 11 district offices take longer than the statewide average of 84 days to process loan applications, and the department's district offices do not have a uniform method of processing loan applications. Delays in processing loan applications have occurred because the department does not have a system to monitor the processing of loan applications in the district offices. The department also has had many unfilled staff positions in its district offices.

Standards for Processing
<u>Loan Applications</u>

To evaluate the department's loan processing time and procedures, we contacted private and federal mortgage lending institutions, including banks, savings and loan associations, and the federal Veterans Administration. We also compared the performances of the department's 11 district offices.

In the private sector, we contacted loan officers of 15 mortgage lending institutions, and, from the information they provided, we calculated that their average time to process home loan applications was 32 days. Most of the lending institutions begin processing loan applications as soon as the applicant submits all of the completed documents. At that time, these institutions verify the applicant's employment, obtain credit information, and conduct an appraisal of the property being purchased. Generally, private lending institutions process several segments of the loan application concurrently.

Most of these private lending institutions have two centralized levels of evaluation for each loan application. First, an underwriter or loan processor reviews the loan application, and then a central loan approval committee makes the final decision to fund the loan. Private institutions also have systems that monitor the processing of loan applications and that identify the time it takes to process an application.

We also spoke to a loan executive with the federal Veterans Administration. The loan executive said that, although the Veterans Administration does not make loans, it authorizes certain banks to approve mortgage loans, which the Veterans Administration insures. However, the Veterans Administration reviews all loans approved by the banks to ensure that the loans comply with federal standards.

The department's Operations Manual provides the district offices with guidelines for processing loan applications. The manual outlines the loan processing procedures that the district offices are to follow and identifies the documents necessary to process and approve a loan application. However, the manual does not specify how long it should take a district office to process a loan application.

Beginning July 1, 1985, the Legislature required the department to process and approve Cal-Vet loans within 90 days. Since our review covers the processing of loan applications for fiscal years 1982-83 through 1984-85, we did not apply this standard in our review.

The Department Takes Too Long To Process Cal-Vet Loans

The department's district offices' average time to process a veterans loan application varies from 67 to 105 days. The average statewide processing time, using the department's guidelines, is 84 days.

The processing of Cal-Vet loans begins at the department's 11 district offices. The staff at the district office review an applicant's credit and employment information, request verification of information if needed, and, finally, prepare a loan analysis of the financial information. District office employees or authorized agents also appraise the property that the veteran wishes to purchase. After staff have completed the loan analysis and appraisal, the district office manager reviews the loan application documents. If the manager approves the loan, the loan application is forwarded to the department headquarters office in Sacramento, which prepares the escrow instructions. The loan application is then processed by the escrow holder and returned to the department for funding.

Determining how long it takes to process an application for a Cal-Vet loan depends upon the date that is chosen to mark the beginning of the process. According to the manager of the department's Farm and Home Loan Division, loan processing begins on the date the veteran submits an application and ends on the date the loan is funded. However, the department's Operations Manual states that district offices are not to begin processing a loan application until the veteran has submitted an application fee and all required documents. Our review disclosed that veterans take an average of 71 days to submit all documents necessary to process loans.

We reviewed a random sample of 304 home loan applications that the department approved and funded during fiscal years 1982-83 and

1984-85. Using the department's method of calculating loan processing time, we found that it took an average of 155 days to process an application. However, using the guidelines in the department's Operations Manual, we found that the average statewide processing time, from the date the veteran submitted the required documents to the date the loan was funded, was 84 days, a difference of 71 days. Thus, in beginning loan processing time on the date a veteran submits an application, the department is including days on which no processing should actually occur. For 125 (41 percent) of the 304 home loan applications we reviewed, district offices should not have begun processing when the application was submitted because veterans had not submitted the documents necessary to process the loans.

As mentioned above, the department's Operations Manual requires loan processing to begin when the veteran submits the required documents. Using this guideline, we calculated the time it took to process home loan applications in the district offices. The average time ranged from 67 days in the Santa Clara district office to 105 days in the San Bernardino district office. Six district offices--Ventura, Redding, South Sacramento, Bakersfield, San Diego, and San Bernardino--took longer than the statewide average of 84 days to process home loan applications. Table 1 below shows the average loan processing time, from completion of the loan requirements to the date of funding, for the department's 11 district offices. (Appendix A presents the distribution of the home loan processing time for each district office and shows the percentage of loan applications processed in each of the time intervals.)

TABLE 1

DEPARTMENT OF VETERANS AFFAIRS DISTRICT OFFICES AVERAGE PROCESSING TIME FOR HOME LOAN APPLICATIONS FISCAL YEARS 1982-83 THROUGH 1984-85

District Office	Average Processing Time (in days)
Santa Clara	67
Concord	69
Lakewood	71
Fresno	73
North Sacramento	77
Ventura	86
Redding	91
South Sacramento	92
Bakersfield	92
San Diego	100
San Bernardino	105

Within the department itself, 5 of the 11 district offices processed loan applications faster than the statewide average. The Fresno district office, one of the 3 offices we visited, processes loan applications faster than the statewide average. In order to assure that all of this district office's loans are being processed promptly, the district manager monitors the progress of loan applications by reviewing the loan applications at least monthly. He identifies any loans delayed in processing and requests that corrective action be taken to prevent any further delay.

In most cases, loan applications were delayed because the district office managers did not approve the loan application as soon as they could have or because district office staff did not begin processing loans as soon as veterans submitted the application fees and documents. Table 2 lists the types of delays and the average number of days that the loan application was delayed by each.

TABLE 2

DEPARTMENT OF VETERANS AFFAIRS
TYPES OF DELAYS IN PROCESSING HOME LOAN APPLICATIONS
FISCAL YEARS 1982-83 THROUGH 1984-85

Type of Delay	Number of Applications	Average Number of Days Delayed
District office managers approval of loans	73	81
District office staff beginning to process loans	68	61
Veteran returning authorization to proceed	18	61
District office forwarding loan package to headquarters	6	22
Title or escrow company taking over 20 days	6	59

In addition to providing home loans for the purchase of existing homes, the department also provides loans to veterans who have constructed a home on an unimproved lot. Of the 355 loan applications

we sampled, 51 applications were for loans to finance homes that veterans had constructed. In handling these loans, the district office first approves the proposed homesite and the veteran's credit and eligibility and then issues a commitment to fund the loan. Because the department does not fund home construction, the veteran may finance the construction of the home through a private lending institution. Upon notification that the construction of the home has been completed, the district office processes the loan application. The average time to process the loan once the home was completed was 71 days.

Loan Processing Procedures Vary Among the District Offices

The department's 11 district offices do not follow the same procedures in processing applications for Cal-Vet loans. Nine of the 11 district offices verify a veteran's credit information using the documentation provided by the veteran. The other two district offices normally use a credit agency to verify a veteran's credit information. For example, the San Bernardino district office obtained credit information through a credit agency for each loan applicant whose downpayment was less than 20 percent of the purchase price of the property. The manager of the Fresno district office told us that his office requested a written credit report from a credit bureau only when the district office staff questioned a veteran's financial eligibility.

The procedures for appraising property also varied among the district offices. Although all of the district offices conducted their

own property appraisals, eight of the district offices had used private appraisers to complete property appraisals during periods of heavy workload in the district offices. The other three district offices did not use private appraisers.

Another variation in the procedures is that district offices did not always complete loan application files and documents according to the department's guidelines. Contrary to the procedures in the department's Operations Manual, the district offices began processing 141 loan applications before veterans had submitted the required documents. Moreover, district managers had not signed documents in 60 loan application files. Finally, certain documents needed to approve the loan were missing from 20 of the loan application files.

Lack of Monitoring, Standards, and Staff Cause Processing Delays

Delays in processing loan applications occurred for several reasons. First, the department does not have a system to monitor the processing of loan applications in the district offices. For example, the department does not routinely prepare summaries of the loan applications being processed and approved by the district offices. Unlike the private lending institutions, which have central loan approval committees that review and approve loans, the department's management does not review the loan applications approved by the district office managers. Thus, the department cannot identify problems in processing loan applications and take the action necessary to correct the problems.

Moreover, the department's Operations Manual does not specify how long it should take for district office staff to process loan applications. Consequently, department management does not have a standard by which to measure the performance of the district offices and to identify problems in processing loans.

Finally, key positions in the department's district offices have been vacant. For example, in comparing authorized to filled positions for each of the district offices, we found 11 unfilled positions (7 percent of total positions) in the district offices during fiscal year 1982-83, 19 unfilled positions (14 percent of total positions) in 1983-84, and 10 unfilled positions (7 percent of total positions) in 1984-85. As of September 1, 1985, one district office manager position was vacant, and 3 of the 11 district offices had various positions unfilled. The San Bernardino district office, for example, has had two unfilled property agent positions since August 1, 1985, and the Bakersfield district office currently has only two of its four authorized property agents. Furthermore, two of the department's three regional supervisor positions are vacant. The regional supervisor is responsible for planning, organizing, and directing the loan processing operations of several district offices. Without supervision of these operations, the department may be unaware of loan processing problems and therefore unable to take the appropriate action to correct the problems.

Delays Force Veterans To Seek Interim Financing

Because the department has delayed processing applications for Cal-Vet loans, some veterans have had to obtain more costly interim financing to purchase their homes. The current interest rate for a Cal-Vet loan is 8 percent. Interest rates charged by private mortgage lending institutions for interim loans to veterans are much higher: three private institutions we contacted were charging approximately 12 percent for interim loans.

In addition to charging higher interest rates, private mortgage institutions assess a service charge on each loan funded and require the veteran to pay fees for processing loan applications. According to the information that loan officers at the private institutions gave us, the average service fee is equal to 2.08 percent of the total amount of the loan, and veterans pay an average loan processing fee of approximately $400. Thus, a veteran seeking interim financing until a Cal-Vet loan is approved could be required to pay a service charge of $1,560 and a loan processing fee of $400 on a loan of $75,000. The veteran would also pay an interest rate that is approximately 50 percent higher than the Cal-Vet rate.

At the three district offices we visited, we reviewed veterans' loan applications to determine the effects of delays in processing applications for Cal-Vet loans. For two veterans who obtained interim financing to purchase their homes, we contacted

officials of the mortgage lending institutions to obtain an estimate of the cost paid by veterans. One veteran paid $1,044 in service charges and fees to finance his home for 154 days until his Cal-Vet loan was approved and funded. In another instance, a veteran obtained interim financing for 138 days at an estimated cost of $2,439. Additionally, both veterans incurred interest charges approximately 50 percent higher than the Cal-Vet rate.

Documentation in the district office files did not indicate why these interim loans were required, so we contacted the veterans. In both of these cases, the veterans told us that they were advised by the district offices to obtain an interim loan. Further, the district offices estimated a 5- to 12-month delay in processing the loan applications and said that funding for the loans was currently not available. In one case, the veteran's application was further delayed because the district office was experiencing difficulty in completing property appraisals.

Corrective Action Taken by the Department

The department has taken some action to speed up the processing of loan applications and to improve loan processing procedures in the district offices. In August 1985, the department issued a directive requiring each district office to form a panel of independent outside property appraisers. According to the northern regional supervisor, the panel is to assist district office staff in

processing loans by completing the appraisals of properties when district office staff are unable to do so.

In addition, the department currently has a project to improve the automated property purchase system. The improved system is designed to reduce the staff time required to process a loan application by eliminating most of the typing and word processing activities in the district offices and by standardizing the processing of loans. The new system is expected to facilitate the coordination of loan processing activities within the department. Finally, the new system is to provide the department with centralized management control of loan application processing by permitting immediate access to individual loan application data and by generating routine summary reports. However, as of October 31, 1985, the test project for the property purchase system had been implemented in only one of the department's 11 district offices.

II

THE DEPARTMENT OF VETERANS AFFAIRS TAKES TOO LONG TO FORECLOSE ON DELINQUENT LOANS AND DOES NOT CONSISTENTLY HANDLE REPOSSESSED PROPERTIES

The department exceeds 120 days before it begins the action necessary to cancel a delinquent loan. In contrast, private lenders initiate action to cancel delinquent loans, on the average, 16 days after the first delinquent payment. Furthermore, the district offices do not follow uniform methods for disposing of repossessed properties, and they are not consistent in giving veterans a preference in purchasing repossessed properties. These inconsistencies occur because the department has not provided the district offices with adequate standards or adequate guidelines on handling repossessed properties. Moreover, the department has not monitored district offices' actions to cancel delinquent loans and resell repossessed properties.

The department's rate for repossessing homes from veterans who fail to make payments is significantly lower than the repossession rates of other lending institutions. However, the department could cancel delinquent loans more promptly. The losses that the department incurs because it does not promptly cancel delinquent loans has not affected the interest rate charged to veterans, but the department loses revenue when a veteran fails to make monthly mortgage payments. Furthermore, the lack of consistency in district office policies for reselling repossessed homes means that veterans may not always receive preference in purchasing repossessed homes.

Procedures for Handling Delinquent Home Loans

Mortgage lending institutions in the private sector generally act quickly to cancel delinquent home loans. On the average, the lending institutions notify the mortgagee of a delinquency 16 days after the payment due date. After the initial delinquency notice, a loan service officer attempts to contact the delinquent mortgagee to develop a plan to keep the loan current; this occurs an average of 22 days after the payment due date. If the mortgagee still does not make payments, the lending institutions cancel the loan in an average of 76 days. In order to repossess the property, the lending institutions file a notice of default with the county recorder's office in an average of 100 days after the initial payment due date. Finally, the lending institutions publicly announce that the property is for sale and then sell the property.

In contrast to the private lending institutions, the department has taken as long as 19 months to cancel delinquent home loans. According to policy, the department sends the veteran a notice of intent to cancel a loan (delinquent account notice) after the veteran's loan payments are in arrears for 3 months. However, the department sends the veteran a notice of cancellation of the loan only after a veteran is in arrears for more than 120 days. Once the notice of intent to cancel has been issued, district office staff contact the veteran to determine if it is possible to keep the loan current. If the veteran cannot keep the loan current, the district office requests

that the department cancel the loan. If the district offices do not complete the request to cancel the loan within 120 days from the date of the first delinquent payment, the department requires the district offices to send a written memorandum to the department stating the reasons for the delay and recommending what action should be taken on the delinquent loan.

District Offices Do Not Act Quickly on Delinquent Home Loans

The department's rate for repossessing homes from veterans who fail to make payments is significantly lower than the repossession rates of other mortgage lending institutions. The department's district offices act much more slowly than do private lending institutions to cancel loans and repossess properties for which veterans fail to make payments for an extended time. In our review of a random sample of 93 properties that the department repossessed, we found instances in which a district office took as long as 21 months to initiate legal action to repossess Cal-Vet property in delinquency. We also found that district offices had not always explained the reasons for delays in cancelling loans.

For example, the Fresno district office delayed taking legal action on delinquent loans in 4 of the 31 cases we reviewed. In one instance, a veteran had not made any payments for 10 months before the district office requested that the department initiate legal action to repossess the home. As of September 1985, the veteran's family had

remained in the home for an additional 31 months without making payments because the department neglected to repossess the property.

In another case, the Fresno district office allowed 19 months to elapse before requesting that the department cancel the delinquent loan. Two months later, or 21 months after the first payment was missed, the district office requested that the department take legal action to evict the veteran from the property. Throughout this period, in accordance with department policy, the district office was in contact with the veteran, who made irregular payments but was not able to make the account current. Although the department requires district offices to provide a memorandum explaining the reasons for not cancelling a delinquent loan that exceeds 120 days, we found no evidence in the department's files that the Fresno district office complied with this requirement.

Inadequate Management Control Causes Delays in Repossessing Property

Private lending institutions closely monitor delinquent accounts to ensure that prompt action is taken to cancel delinquent loans. The department, however, does not exercise adequate control over the district offices to ensure that they take action to repossess property as quickly as they should. Although the department has established procedures for district offices to follow in initiating action to cancel delinquent loans, the department has not set a time by which district offices must take action. Further, the department does

not receive routine reports from the district offices on delinquent loans that require action by the district offices. As a result, the department's management cannot track delinquent loans or initiate corrective action with the appropriate district office.

The department routinely issues a notice of intent to cancel a loan to veterans whose loans are delinquent. However, the department is not taking prompt action to cancel loans because the district offices do not always notify the department that the loans should be cancelled and because the department does not routinely review ongoing activities in the district offices. Moreover, although the manager of the department's Farm and Home Loan Division states that district offices should take action to cancel a delinquent loan in 120 days, the department has not specified a maximum time by which the district office must act to cancel the loan. Consequently, the department cannot assess the district offices' timeliness in taking action on delinquent accounts.

Delays Lead to Lost Revenue and Increased Costs

The losses incurred by the department resulting from delays in cancelling delinquent loans have not affected the interest rate charged to veterans. However, the department loses revenue when a veteran fails to make monthly mortgage payments because the department must absorb that portion of the bond debt. In one case, for example, a veteran was delinquent for 21 months before the district office

initiated legal action to repossess the property. The veteran's loan payments were over $3,700 in arrears, and the department had to spend almost $3,700 to repair and resell the property.

In another instance, the Fresno district office did not request the department to initiate legal action to repossess a home for almost 15 months, resulting in a cost to the department of over $3,500. During this period, the district office negotiated three different repayment plans with the veteran to get the loan payments current. However, the veteran failed to comply with the terms of each repayment plan. According to the district office manager, the department eventually had to spend over $5,100 to renovate the home in order to sell it. We found no evidence in the department's files that the district office had advised the department of the delay in cancelling this loan.

The department also requires that, in addition to their other duties, property agents determine occupancy and complete an appraisal of the properties when loans are delinquent. According to headquarters and district office staff, when the district offices delay in repossessing and selling delinquent properties, property agents' workload is increased because they must continue to visit and inspect these properties.

The Department Is Not Consistent in Its Methods of Selling Repossessed Property

The district offices do not have uniform methods for disposing of repossessed properties. Moreover, the department has not monitored the district offices' resale of repossessed properties to ensure that their methods are consistent and that veterans are receiving preference in the purchase of these properties. As a result of these inconsistent methods, veterans are not always receiving the special consideration required by department policy at all of the district offices.

The intent of the Cal-Vet loan program is to provide low interest home loans to veterans. The department provides district offices with general guidelines for selling a property, and department policy permits the manager of the district office to determine how a property will be sold. If the property is financed through a Cal-Vet loan, the district manager must limit the sale to qualified California veterans. If qualified veterans are not interested, the district manager may sell the property to a nonveteran. A nonveteran may purchase a repossessed property through a Cal-Vet loan, but the interest rate will be 2 percent higher than the current interest rate for California veterans. In addition, any buyer must use the property as a personal residence. The only exception to these requirements is repossessed property that is sold for cash. In that case, the district manager may sell the property to any buyer.

The district offices' methods for disposing of repossessed properties differ. Eight of the 11 district offices we contacted give veterans priority to purchase repossessed properties. The North Sacramento and Fresno district offices indicated that they regularly advertise properties and accept bids. For example, the manager of the North Sacramento district office advertises properties, accepts bids for a specified period, and gives veterans preference to purchase the property. Veterans purchased 8 (73 percent) of the 11 repossessed homes in our sample of homes sold by the North Sacramento district office.

Other district offices, however, use different methods to sell properties, and they do not give veterans preference. For example, the manager of the Fresno district office advertises repossessed properties without specifying a date by which bids are to be submitted. Instead, the district manager accepts the first bid that equals the market value of the property. The San Bernardino district office does not always list repossessed properties with real estate brokers, and the district manager takes the first "acceptable" offer for the property.

Nonveterans Purchase Most Repossessed Property

Although veterans are supposed to receive preference for loans under the department's Cal-Vet program, our analysis indicates that nonveterans purchased most of the repossessed properties that were sold during fiscal years 1982-83 and 1984-85. Of the 93 repossessed homes

in our sample, nonveterans purchased 54 (58 percent) while veterans purchased 39 (42 percent). Although each purchaser of a repossessed home in our sample received a Cal-Vet loan, we found no evidence that the properties were being used for income purposes. We also found that none of the homes were purchased by department employees. Table 3 below shows, by district office, the number of veterans and nonveterans who purchased the 93 repossessed homes in our sample.

TABLE 3

PURCHASERS OF REPOSSESSED HOMES BY DISTRICT OFFICE
SAMPLE OF 93 HOMES
FISCAL YEARS 1982-83 TO 1984-85

	Purchaser		Percent of Purchases	
District Office	Veterans	Nonveterans	Veterans	Nonveterans
Bakersfield	0	3	0%	100%
Concord	1	0	100%	0%
Fresno	14	15	48%	52%
Lakewood	1	2	33%	67%
Redding	3	14	18%	82%
North Sacramento	8	3	73%	27%
South Sacramento	4	4	50%	50%
San Bernardino	3	4	43%	57%
San Diego	2	8	20%	80%
Santa Clara	0	0	0%	0%
Ventura	3	1	75%	25%
Total	39	54	42%	58%

The department's district offices use varying methods to sell repossessed properties because the department does not monitor the procedures for handling repossessed properties. The department does not receive reports of how the district offices are selling repossessed properties or to whom they are selling the properties. Also, the department does not review the files of repossessed homes to evaluate the procedures that the district offices use. Because they do not use the same methods in selling repossessed homes, district offices do not always give veterans special consideration in purchasing these homes.

Corrective Action Taken by the Department

During our review, the department issued a directive requiring district offices to advertise and solicit sealed bids on repossessed properties. This directive further requires all district offices to make every reasonable effort to sell repossessed properties to qualified, eligible California veterans. Finally, the directive stipulates that the director must approve purchases of repossessed homes by department employees.

Additionally, before we began our review, the department began testing a computerized system to improve the property purchase system. This system is designed, among other things, to expand the department's management information capability to provide the current status of individual loans. However, as of October 31, 1985, the department had not completed its testing of this system.

III

CONCLUSION AND RECOMMENDATIONS

The department takes an average of 84 days to process applications for Cal-Vet home loans; 6 of the department's 11 district offices take longer than this average. In contrast, private mortgage lending institutions process loan applications in an average of 32 days. The departments' district offices also do not follow the same procedures in processing loan applications. Furthermore, the department does not have a system to monitor the loan processing operations of its district offices, it does not have time standards for processing loan applications, and it has had unfilled positions in its district offices. Consequently, some veterans have experienced delays in obtaining their Cal-Vet loans and have had to seek interim, more expensive financing.

Moreover, the department exceeds 120 days before it takes action to cancel a delinquent loan. In contrast, private lenders initiate action to cancel loans, on the average, 16 days after the first delinquent payment. Furthermore, the district offices do not have uniform methods for disposing of repossessed properties, and they are not consistent in giving veterans a preference in purchasing these properties. These inconsistencies occur because the department has not provided the district offices with adequate standards or adequate guidelines for handling these properties. Additionally, the department

has not monitored district offices' actions to cancel delinquent loans and resell repossessed properties.

Finally, the department's rate for repossessing homes from veterans who fail to make payments is significantly lower than repossession rates of other lending institutions. However, the department could cancel delinquent loans more promptly. Although the losses that the department has incurred because of delays in cancelling delinquent loans have not affected the interest rate charged to veterans, the department loses revenue when a veteran fails to make monthly mortgage payments. Furthermore, because of the lack of consistency in the district offices' policies in reselling repossessed homes, the department does not ensure that veterans always receive preference in purchasing these homes.

RECOMMENDATIONS

To improve the management of the loan processing system and ensure that loan applications are processed promptly, the Department of Veterans Affairs should take the following actions:

- Establish time standards and guidelines for district offices to follow in processing loan applications;

- Process loan applications only when a veteran has provided all required documents according to department guidelines;

- Implement a statewide management information system to monitor loan processing in the district offices by recording and compiling loan processing information;

- Routinely review a sample of loan applications that have been approved and funded to ensure that the loans are being approved according to the department's standards and guidelines; and

- Fill vacant positions in the district offices as soon as possible to ensure that the offices have sufficient staff to process loan applications according to the established time standards.

To decrease the time required to foreclose on a delinquent loan, the department should establish a time limit by which district offices must act to cancel a delinquent loan and include in its management information system the tracking of repossessed properties.

To ensure consistency in disposing of repossessed homes among all the district offices and to ensure that veterans are given preference, the department should regularly monitor the district offices to ensure that they are following the department's policy in selling repossessed homes and that they are giving veterans priority to purchase these homes.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

Thomas W. Hayes

THOMAS W. HAYES
Auditor General

Date: November 25, 1985

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State and Consumer Services Agency

OFFICE OF THE SECRETARY
915 Capitol Mall, Suite 200
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November 21, 1985

Mr. Thomas W. Hayes
Auditor General
Office of the Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Hayes:

The State and Consumer Services Agency has reviewed the Auditor General Report, P-548, entitled "Better Administration at the Department of Veterans Affairs Can Improve Services To Veterans." We feel the report identifies areas where improvements can be made and recognizes the positive actions already taken by the Department of Veterans Affairs. Responses to specific recommendations contained in the report are following:

1. Recommendation: That the Department "establish time standards and guidelines for district offices to follow in processing loan applications."

   Response: The Department has recently established time standards and guidelines which will ensure that Cal-Vet loan applications are processed within 90 days after receipt of full documentation from the veteran.

2. Recommendation: That the Department "process loan applications only when a veteran has provided all required documents according to its own guidelines."

   Response: Although this had been the informal practice for some time, this recommendation has been adopted and instructions have been issued by the Department to its district offices.

3. Recommendation: That the Department "implement a statewide management information system to monitor loan processing in the district offices by recording and compiling loan processing information."

   Response: A new automated loan processing and information system is being implemented throughout all district offices which will allow tracking through the loan processing stages to monitor processing time and also to identify loans, by district office, not completed within the established time standards in order to take remedial action.

The Department, in October 1985, implemented an initial phase of a Management Information System to track loan processing time from a completed application through loan funding.

4. Recommendation: That the Department "routinely review a sample of loan applications that have been approved and funded to ensure that the loans are being approved according to the Department's standards and guidelines."

   Response: The Department is establishing a quality control system to review a sample of loan applications both in process and approved for funding. This system will be a centralized responsibility of the Regional Managers and will also be subject to field audits by Central Office staff.

5. Recommendation: That the Department "fill vacant positions in the District Offices as soon as possible to ensure that the offices have sufficient staff to process loan applications according to the established time standards."

   Response: The Department currently has 7 vacancies out of 143 District Office positions (5%), which will be filled as soon as possible. The vacancies are in locations where the Department has traditionally experienced difficulty in recruiting.

6. Recommendation: To decrease the time required to foreclose on a delinquent loan, the Department should establish a time limit by which district offices must act to cancel a delinquent loan and establish a management information system to include tracking repossessed properties.

   Response: The Department will aggressively pursue the reduction of the time for issuance of "Notices of Intent to Cancel Contract" from 3 months to 2 months. The contract holder will then have 30 days to clear the delinquency. A system of monthly reporting is being implemented to track the progress of delinquent account activity. There will also be a monitoring procedure established to ensure that the District Offices take action at the end of the 90-day period.

7. Recommendation: To ensure consistency throughout district offices in disposing of repossessed homes and to ensure that veterans are given preference, the Department should establish a uniform statewide policy for selling repossessed homes. The Department should also regularly monitor the district offices to ensure compliance with this policy.

Response: On August 16, 1985, the Department issued a directive to all District Offices which established a uniform statewide policy consistent with this recommendation. In addition, the Department has prepared a procedures manual outlining the steps required to repossess properties and all district offices have been trained in its use.* Central Office staff are now routinely auditing each district office to ensure ongoing compliance with these procedures.

The implementation of these and other changes to the California Farm and Home Loan Progam will ensure that practices within this program are more consistent with those expected from the private sector. This will result in a higher level of service and maximize the benefits available in this program for all of California veterans.

Sincerely,

SHIRLEY R. CHILTON
Secretary of the Agency

*Auditor General Comment: Text of the recommendation changed.

DEPARTMENT OF VETERANS AFFAIRS DISTRICT OFFICES
DISTRIBUTION OF PROCESSING TIME FOR HOME LOANS
FISCAL YEARS 1982-83 THROUGH 1984-85

	Loan Processing Days						Total Loan Applications Reviewed
District Office	0-30	31-60	61-90	91-120	121-150	Over 150	
Bakersfield	2	4	3	2	5	2	18
Concord	5	7	4	3	2	1	22
Fresno	6	13	10	6	5	1	41
Lakewood	3	7	5	2	1	2	20
North Sacramento	5	10	12	7	5	2	41
Redding	1	10	5	6	6	3	31
San Bernardino	4	10	5	4	5	6	34
San Diego	3	4	2	7	5	3	24
Santa Clara	3	6	5	0	2	1	17
South Sacramento	2	10	4	5	0	5	26
Ventura	3	9	4	9	2	3	30
Statewide	37	90	59	51	38	29	304
Percent of Total	12.2	29.6	19.4	16.8	12.5	9.5	100
Cumulative Percentage	12.2	41.8	61.2	78.0	90.5	100	

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps